ARCO OIL & GAS CO.

IBLA 90-314 Decided December 2, 1994

Appeal from a decision of the Director, Minerals Management Service, affirming, in part, an order assessing additional royalties for underpayment of the proceeds paid for royalty-in-kind crude oil. MMS-86-0214-O&G.

Affirmed in part; reversed in part.

1. Accounts: Payments--Oil and Gas Leases: Royalties: Payments

A demand by MMS directed to an oil and gas lessee for additional royalty payments based on the underreporting of the volume of royalty-in-kind crude oil delivered to a purchaser during the period from January 1, 1977, through May 31, 1982, will be reversed where the record establishes that the lessee did, in fact, deliver the correct volume of oil to the purchaser.

2. Accounts: Payments--Oil and Gas Leases: Royalties: Payments

A demand by MMS directed to an oil and gas lessee for additional royalty payments based on the miscategorization of royalty-in-kind crude oil delivered to a purchaser during a period of price controls will be affirmed where the record establishes that the effect of this miscategorization was to deprive the Government of the percentage of the full value of the production to which it was entitled.

3. Administrative Authority: Generally--Statute of Limitations

A statute establishing time limitations for commencement of judicial actions for damages on behalf of the United States does not limit administrative proceedings within the Department of the Interior.

APPEARANCES: Kathleen T. Scott, Esq., Dallas, Texas, for appellant; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., and Howard W. Chalker, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE BURSKI

ARCO Oil and Gas Company (ARCO) has appealed from that part of the decision of the Director, Minerals Management Service (MMS), dated March 12, 1990, which denied the appeal of Tenneco Oil Company (Tenneco), ARCO's predecessor-in-interest, from an order dated March 31, 1986, issued by the Chief of the Royalty Compliance Division (RCD), MMS, directing the payment of additional royalty on two oil and gas leases, No. 80-019392 (Oxford) and No. 80-021130 (Kendon).

The order of the Chief, RCD, had directed Tenneco to pay additional royalties totaling $317,495 based on reporting errors discovered by an audit of the subject leases for the period from January 1, 1977, through May 31, 1982, which had been conducted by the California State Controller's Office (SCO), pursuant to section 205 of the Federal Oil & Gas Royalty Management Act of 1982 (FOGRMA), 30 U.S.C. § 1735 (1988). In support of this demand, the order recited that, during the period of time in question, the Government had elected to take its royalty in kind and had entered into a Royalty Oil Contract with West Coast Oil Company (West Coast). Though it was undisputed that Tenneco made the deliveries to West Coast required by its leases, the audit disclosed that Tenneco had failed to properly report sales volumes, had failed to include changes in sales values, and had failed to report the proper price on production and sales volumes exceeding its base production control levels. The Chief, RCD, noted that, as a result of these deficiencies, the Department did not properly bill West Coast for the amount due under its royalty oil contract and that it was no longer able to do so since the royalty contract between West Coast and the United States had been terminated and West Coast's letter of credit had expired. Accordingly, the Chief held that Tenneco was responsible for the royalty shortage.

The decision of the Director, MMS, generally reversed this determination insofar as it related to the underreporting of <u>values</u> but affirmed the decision with respect to the underreporting of <u>volumes</u>. The Director based this dichotomy on an analysis of certain MMS decisions which, he concluded, had established this bifurcated approach

> based upon the reasoning that the lessor must rely upon the producer's reports for the correct volume in order to properly bill the refiner purchasing the RIK [royalty-in-kind] crude oil, but the lessor is capable of independently discerning the proper value of the crude oil produced because of the lessor's access to information concerning other production from the field or area from which the RIK crude oil is produced.

(Decision at 3).

Applying the foregoing rationale to the specifics of the case before him, the Director held that Tenneco was not liable for assessed royalty underpayments in the amount of $114,380, which underpayments had been assertedly occasioned by Tenneco's erroneous reporting of the values obtained for crude oil production delivered to West Coast since the Government could have determined the correct values independent of the producer's reports (Decision at 5). However, the Director differentiated between erroneous reports of the values obtained by Tenneco and erroneous reports of the crude oil's proper category or vintage for valuation purposes. The Director argued that, while the former were subject to independent verification by the Government, the latter were not. Improper categorization of crude oil, in effect, prevented both the Government and the refiner from obtaining the maximum allowable value for the delivered crude oil and, the Director reasoned, Tenneco, having caused the shortfall by its erroneous report, was properly held liable to the Government for the additional value which would have been received had the Government or the refiner been correctly notified of the vintage of the crude oil delivered. Thus, the Director affirmed the assessment of $19,397 for production from the Oxford lease which had been reported as lower tier crude oil subject to then-existing price controls but which should have correctly been reported as decontrolled production which was eligible to be sold at the higher market price.

Insofar as the assessment for royalty underpayments relating to the underreporting of volumes was concerned, the Director affirmed the decision of the Chief, RCD, that Tenneco was liable for $183,718 in additional royalties. While recognizing that this Board had reversed an earlier decision holding a lessee liable for late payment charges based on underreporting of RIK volumes delivered to a refiner (see Mobil Oil Corp., 107 IBLA 332 (1989)), the Director, MMS, construed this decision as only preventing the assessment of late payment charges and not controlling the assessment of additional royalties. Accordingly, the Director affirmed a total assessment of $203,115 against Tenneco for the asserted underpayments in royalties. Tenneco thereupon pursued the instant appeal.

In its appeal to the Board, ARCO raises numerous challenges to the imposition of additional royalties. For the reasons set forth below, to the extent that the demand for additional royalties was premised on alleged underreporting of RIK volumes, we agree with ARCO that there is no basis for the decision of the MMS Director.

[1] Initially, we must admit that we find it difficult to credit MMS'contention that it must rely on the reports of its lessee in order to determine the volumes delivered to the refineries. Not only do we have considerable difficulty believing that the refineries do not maintain their own records of the amount of crude oil which they receive, we would point out that the April 30, 1976, letter from the Oil and Gas Supervisor, Geological Survey, 1/ notifying Tenneco that the Government had elected to

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1/ By Secretarial Order No. 3071, dated Jan. 19, 1982, as amended May 10, 1982, all minerals management functions previously exercised by the Conservation Division, Geological Survey, were transferred to MMS. By Secretarial Order No. 3087, dated Dec. 3, 1982, as amended Feb. 7, 1983, the onshore, nonroyalty management functions of MMS were transferred to the Bureau of Land Management.

take RIK on the leaseholds and had entered into a sales contract with West Coast had, itself, noted that the "[p]urchaser's pipeline or other settlement statements will also be submitted to confirm the actual sales volumes." This clearly indicates that the Geological Survey not only had the ability to verify the volumes delivered but fully intended to do so as a check on the lessee. Thus, the Director's suggestion that MMS had no choice but to rely on the volume data supplied by Tenneco is simply not borne out by the record. 2/

Moreover, the Director's attempt to distinguish our decision in Mobil Oil Corp., supra, from the fact situation presented in the instant appeal does not withstand analysis. It is true, of course, that the Mobil case involved only the question of the imposition of late payment charges and not the assessment of additional royalties. The reason for this, however, is that, after it was discovered that Mobil had underreported RIK volumes delivered to two refiners, the Department billed the refiners for the additional volumes and only sought to assess late payment charges against Mobil. In reversing a determination of the Director, MMS, upholding the assessment against Mobil, the Board recognized that Mobil's inaccurate reports clearly constituted a reporting violation which subjected it to an assessment under 30 CFR 218.40(b) (1989). The Board held, however, that, inasmuch as Mobil had, in fact, timely delivered the RIK oil to the refiners, there was no late payment of royalty and, therefore, there could be no assessment of a late payment charge under 30 CFR 218.150(d) (1989). Thus, the ratio decedendi of the decision in Mobil Oil Corp. was premised on the conclusion that actual delivery of the proper amount of RIK oil to the designated refiner constituted payment of the royalty regardless of whether or not the amount delivered was accurately reflected in the reports filed with MMS. We would point out that it is undisputed in the instant case that Tenneco delivered to West Coast all volumes which it was required to under the lease.

In any event, the applicability of the Mobil decision to claims by MMS for additional royalties from lessees based on underreporting of RIK oil deliveries was directly addressed in our recent decision in

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2/ We recognize that, in support of its decision in this case, MMS submitted an affidavit from the Area Supervisory Accountant asserting that, under the procedures actually utilized, Geological Survey relied totally on the volumes and values reported by the producer and that, absent an audit of the producer, there was no way to independently verify whether the proper volumes had been reported. This submission, however, confuses the question of whether, given the procedures under which Geological Survey operated, it would have been apprised of any reporting error with the question whether it could have acquired this knowledge. It seems to us that it would have been a simple matter to require West Coast, or any other purchaser of RIK oil, to file monthly reports of the amounts delivered by the producer and then to compare the data received from the producer with that submitted by the refiner. Indeed, the implementation of such a reporting system was clearly presupposed in the letter of Apr. 30, 1976, which was sent to Tenneco. Geological Survey's failure to establish such a system is not the fault of Tenneco.

Texaco, Inc., 129 IBLA 46 (1994). Therein, faced with a similar contention that the lessee was liable for underpayment of royalties where it had actually delivered the amount required but had erroneously underreported the amount of its deliveries, we concluded that, while Texaco had clearly made reporting errors, it had, in fact, "fulfilled its royalty obligations by delivering the proper volumes of RIK oil" to the purchaser. Id. at 50. Accordingly, we rejected MMS's attempt to recover additional royalties from Texaco for RIK oil which was delivered but not properly reported. 3/ The same result must obtain herein. The Director's determination that Tenneco was responsible for underpaid royalties in the amount of $183,718 because it underreported volumes of RIK oil delivered to West Coast is hereby reversed.

[2] To the extent, however, that the Director upheld the assessment of additional royalties in the amount of $19,397 for production from the Oxford lease which had been incorrectly reported as lower tier crude oil subject to price controls rather than as decontrolled production eligible for the higher market price, we believe that his decision is properly sustained.

Under the system of price controls in effect during the period in question, determination of the vintage or category of production controlled the price which could be obtained for that production. Thus, the categorization of production effectively determined the value of production. Under section 2(e) of its lease, Tenneco was required to remit a specified percentage of the value of its production as royalty to the United States. This payment, of course, could be made by either money or RIK oil, depending upon the election of the United States. In either case, however, the royalty obligation was discharged only when the requisite percentage of value was delivered to the United States.

In Transco Exploration Co., 110 IBLA 282, 323-26, 96 I.D. 367, 389-91 (1989), we held that a lessee was liable for additional royalties where it failed to timely obtain a deregulated price available to it. In essence, we held that, regardless of the value which the lessee may have, itself, obtained, its failure to avail itself of the opportunity to obtain an available higher price for its production did not bar the United States from requiring that the lessee tender royalties at this higher available price. The value of the production on which royalty was due was, thus, not the

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3/ In Texaco, we adverted to the fact that, in 1987, the Department promulgated a new regulation which provides that "[i]f MMS underbills a purchaser under a royalty oil contract because of a payor's underreporting or failure to report on Forms MMS-2014 pursuant to 30 CFR 210.52, the payor will be liable for payments of such underbilled amounts, plus interest, if they are unrecoverable from the purchaser or the surety related to the contract." See 30 CFR 208.13(b). We need not examine the nature and scope of this regulation herein, since it was not in effect during the period under review.

actual value received but the value which could have been received had the lessee acted with due diligence. Accord Anadarko Petroleum Corp., 122 IBLA 141 (1992); FMP Operating Co., 121 IBLA 328 (1991).

We believe that application of the same principle herein requires affirmation of the demand for additional royalties relating to the miscategorization of the delivered RIK oil. Where, during a period of price controls, the Government takes its royalty in RIK oil, the Government does not receive the percentage of the value of the production to which it is entitled unless it receives oil which is properly categorized. Denomination of delivered RIK oil as lower tier crude oil when it should have been classified as decontrolled production, in effect, constituted payment of less than the amount required under the lease, since it understated the value of production. 4/ Tenneco was properly directed to submit additional royalties to compensate for this lost value. That part of the Director's decision which directed payment of $19,397 for miscategorization of the delivered RIK oil is, therefore, affirmed.

[3] ARCO also argues that the MMS decision requiring the payment of additional royalties is barred by the statute of limitations set forth at 28 U.S.C. § 2415(a) (1988), and further suggests that the demand for royalties is inconsistent with the provisions of sections 103(b) and 307 of FOGRMA, 30 U.S.C. §§ 1713(b) and 1755 (1988). The Board has examined these contentions in the past and has consistently rejected them.

Thus, the Board has repeatedly held that, while statutes of limitations may apply to judicial enforcement of administrative actions, they are not applicable to the underlying administrative proceedings. See, e.g., Chevron U.S.A., Inc., 129 IBLA 151 (1994); Forrest Oil Corp., 111 IBLA 284 (1989). Similarly, we have held that nothing in the record-keeping provisions of section 103(b) of FOGRMA, 30 U.S.C. § 1713(b) (1988), operates as a statute of limitations (see Texaco, Inc., supra at 48-49) and have also noted that the limitations provided by section 307 of FOGRMA, 30 U.S.C. § 1755 (1988), are, by the express language of that section, applicable only to actions to recover penalties and would not bar an action to recover royalties determined to be due and owing. See Chevron U.S.A., Inc., supra at 155. We adhere to our prior rulings on these questions.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Director, MMS, is affirmed with respect to the determination that appellant owes $19,397 in additional royalties because of its miscategorization of RIK oil delivered to West Coast but reversed with respect to the demand that

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4/ As SCO noted in its Field Report dated Dec. 30, 1986, independent determination by the Geological Survey of the proper vintage of oil would be impossible since Survey did not have sufficient information to establish the base price control level at any given time or to determine the proper tier at which the oil was classified. See Field Report of Dec. 30, 1986, at 6.

appellant tender an additional $183,718 royalties related to its underreporting of the volumes of RIK oil delivered to West Coast.

James L. Burski
Administrative Judge

I concur:

Gail M. Frazier
Administrative Judge